



The Conference Board

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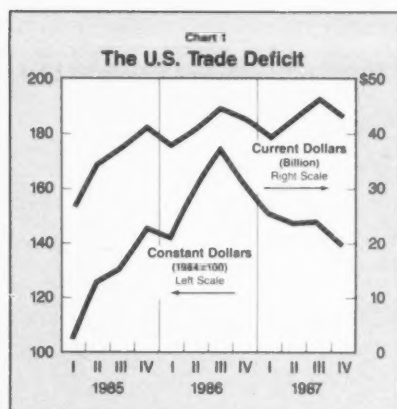
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U.S. FOREIGN TRADE At A Turning Point?

Financial markets in general view the [trade] deficit as a monthly measure of U.S. economic health.
The Wall Street Journal



Source: Department of Commerce

One need not agree with the above to conclude that the January-February 1988 trade data look slightly encouraging and seem to confirm the improvement in the U.S. trade position that became apparent toward the end of 1987. True, even at the January-February rate, the United States would chalk up close to a \$160 billion deficit in 1988. True, the January 1987 results looked similarly favorable and were reversed in the ensuing months. True, the U.S. bilateral deficits with Western Europe and Japan still loom exceedingly large. But despite these provisos and what Deutsche Bank has called "the notorious fragility" of the monthly data, one can discern a turning point in the U.S. trade accounts:

- In volume terms—that is, in constant dollars—the deficit has been declining since the fourth quarter of 1986 (Chart 1).
- There has been a marked expansion in exports from such major categories as machinery and equipment and consumer goods (Chart 2).
- The deficits on the U.S. trade accounts with its largest trading partners—Japan, Western Europe and Canada—are now a smaller share of the total U.S. trade deficit than in 1986 (Chart 3).

As a result of the improved trade picture, 1 to 1.5 percentage points may be added to the U.S. growth rate in 1988.

What the "Current" Numbers Show

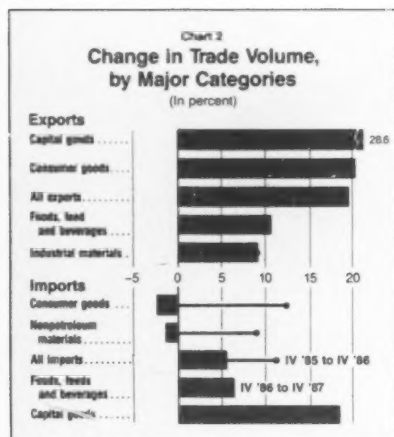
The year 1987 saw the largest trade deficit in U.S. history—\$171.2 billion. This widening, from \$156.2 billion in 1986, can be attributed to the fact that the value of both exports and imports rose at approximately the same rates (11.5 and 10.7 percent, respectively). Given the large discrepancy between the two categories—with imports almost 70 percent higher than exports—exports would have to grow almost twice as fast as imports just to stop the trade balance from deteriorating further in 1988.

It is unfortunate that so much importance is given to the month-by-month changes in the trade data in current dollars, i.e., in value terms. There is, of course, plenty of validity to current-dollar figures: For one thing, the U.S. current account, which measures the change in the total U.S. international position, is reported in current dollars only; for another, interest and dividend payments to foreign owners of dollar assets have to be made (and hence earned) in current dollars; and third, companies' international operations and earnings are all recorded in current dollars.

However, in using the monthly figures—which both the media and the financial markets dote on—one must bear in mind several caveats. First, the data are not seasonally adjusted—and seasonal factors tend to make reported deficits smaller during the first half of the year and larger during the second half. (The Commerce Department is planning to publish seasonally adjusted figures beginning with the April data, to be released in mid-June). Second, there is what has been called “the potentially erratic pattern of crude oil imports.” These exhibit often wide fluctuations in both volume and price. Thus, the *nonpetroleum* deficit last year was only some \$6 billion above that of 1986.

Third, with imports valued at spot exchange rates on the day import entry forms are filed with Customs, a sharp drop in the dollar from one month to the next can easily cause a jump in import values. Finally, aircraft shipments—for years the leading U.S. export item—can vary by as much as \$1 billion from one month to the next.

The “Real” Story



Source: Department of Commerce

The more important clues are to be found in the “real” trade balance, which affects the national accounts and hence the performance of the U.S. economy as a whole. Thus, between 1980 and 1986, the trade balance (on goods and services combined) swung from a \$57 billion surplus, in constant dollars, to a \$146 billion deficit. This deterioration of over \$200 billion in the country’s net exports resulted in a loss of nearly 1 percentage point in U.S. economic growth—to a 2.6 percent annual average. In contrast, in 1988 the turnaround in the U.S. trade position will have a positive effect on the economy.

The improvement in the U.S. trade account will have negative implications for other countries’ growth prospects in 1988, however. The OECD has calculated that if the dollar were to stay at its November 1987 level (DM 1.66 and Yen 133), then Europe’s growth would be reduced by 0.75 percent this year (Table 1). According to OECD calculations, if the dollar were to depreciate by another 15 percent from last November’s level—that is, to DM 1.41 and Yen 114—domestic demand in both Europe and Japan would have to increase by almost 1 full percentage point this year in order to offset the slowdown of foreign demand. While such a depreciation is by no means assured, this scenario calls for Europe and Japanese policymakers to do more to stimulate demand in their countries.

This argument has now permeated economic journalism and is even influencing high-level policy thinking. For example, the British Chancellor of the Exchequer, Nigel Lawson, recently suggested that growth in demand in surplus countries coupled with a decline in demand in deficit countries would be sufficient to solve global trade imbalances, without further depreciation of the dollar.

However, the real world does not work quite that way, since the residents of different countries spend their incomes differently and, in fact, spend the largest proportion on goods and services produced at home. As Professor Paul Krugman of MIT wrote recently, “Even in import-hungry America, well over 90 cents of each dollar of spending goes to goods and services produced here. . . [while] no more than 2 or 3 percent of Japan’s spending is on goods made in the U.S. If the U.S. cuts its expenditures without doing something else at the same time, there will be a fall in the demand for U.S. goods; even if other countries simultaneously increase their spending by the same amount, their increased demand for U.S. exports will compensate for only a small fraction of the reduction in domestic demand.”

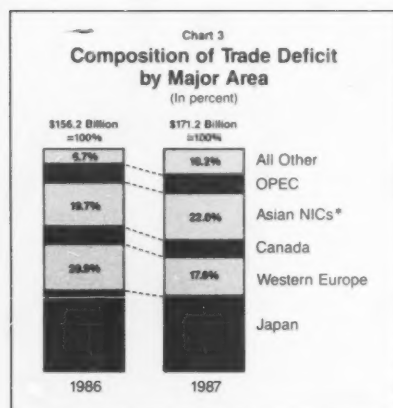
Table 1
Sources of Growth, 1987 and 1988
 (annual change, in percent)

	1987*	1988**
United States		
Domestic demand	2.0	1.0
Foreign demand	0.75	1.5
Total demand	2.75	2.5
Western Europe		
Domestic demand	3.25	2.5
Foreign demand	-1.0	-0.75
Total demand	2.25	1.75
Japan		
Domestic demand	4.25	4.0
Foreign demand	-0.75	-0.5
Total demand	3.5	3.5

Source: OECD

*estimate

**forecast



* Hong Kong, Singapore, South Korea and Taiwan

Source: Department of Commerce

This line of reasoning leads, of course, to calls for a further fall in the dollar—since to make things work out, the rest of the world obviously has to shift a larger part of its (increased) spending from domestic to U.S. goods. Advocates of such a course argue that the only way to achieve this is to make U.S. goods and services still cheaper.

However, one side effect of a still lower dollar would be a further rise in import prices and, with it, a further fall in the terms of trade (Chart 4)—the ratio of the prices of exports to the prices of imports. Such a fall means that the same quantity of exports no longer buys as large a physical quantity of imports as before. Thus, while higher exports will help boost the output of goods and services, the country's so-called "command" over goods and services from domestic production will have declined—and we will truly have tightened our belts.

The Deficit and the Trade Bill

The sharp rise in the 1988 trade deficit has of course had some effect on the fate of the trade bill currently before the Congress. This is especially true for various amendments that would have restricted trade with those foreign countries that have fairly large trade surpluses with the United States: Japan, Taiwan, West Germany, Canada, and so on.

Such measures always run the risk of retaliatory action by the countries affected. But in the case of the United States, there is an added irony. A recent National Foreign Trade Council compilation has shown that the countries where the United States enjoys the largest markets for its exports also tend to be countries with which the U.S. has the largest trade deficits (Table 2).

Table 2
Top 10 U.S. Trading Partners Ranked
According to Three Criteria

*Ranked by total trade
(exports plus imports)*

1. Canada
2. Japan
3. West Germany
4. Mexico
5. Taiwan
6. United Kingdom
7. South Korea
8. France
9. Italy
10. Hong Kong

*Ranked by size of
trade imbalance*

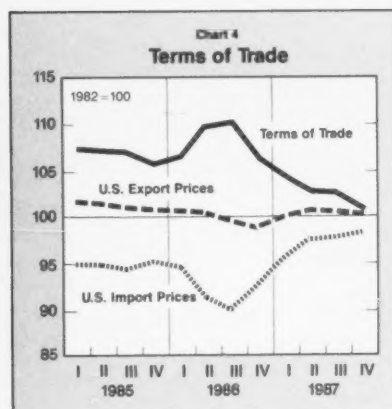
1. Japan
2. Taiwan
3. West Germany
4. Canada
5. South Korea
6. Mexico
7. Hong Kong
8. Italy
9. Brazil
10. China

*Ranked by size of
U.S. export market*

1. Canada
2. Japan
3. United Kingdom
4. Mexico
5. West Germany
6. Netherlands
7. South Korea
8. France
9. Taiwan
10. Belgium

Source: National Foreign Trade Council.

Trade and the Global Factory



Source: Department of Commerce

Finally, there is an issue that has been raised repeatedly in this publication—that of the globalization of manufacturing, including sourcing from a number of different countries and increased in-house or intracompany trade. This development has dulled the responsiveness of our trade accounts in general to exchange-rate shifts. Firms that rely on a global network of facilities to support their U.S. operations can react differently to exchange-rate shifts than firms that are supplied by a company that is foreign. Thus, as this phenomenon increases and as a greater share of U.S. trade comes to involve transactions between affiliated parties, less and less of U.S. trade will become sensitive to exchange-rate swings.

This phenomenon is of course not limited to U.S. multinationals. For instance, as Japanese firms increase their investment in this country, and move facilities into Southeast Asia to escape the effects of the appreciated yen, the proportion of total world trade subject to “globalization” will rise further. In the case of the Japanese automakers investing in the United States, a large amount of “tied trade” in imported subassemblies and parts likewise will be less influenced by the exchange rate than fully assembled imports would be. Still, the U.S. is certainly far from the point, recently postulated by a Washington consultant, where the Japanese will produce so much here that within a few years “hardly any” goods would be imported from Japan.

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